Saudi Banks Comments on BCBS CD:

"Simplified alternative to the standardised approach to market risk capital requirements"

Bank 1

The reduced sensitivities based method (R-SbM) is definitely a lot less complicated approach compared to the original SbM prescribed by Basel in Jan 2016 but it still poses a significant computational challenge for banks. Most of the banks, especially in the region will be obliged to upgrade their IT and systems capability before they are able to move to SbM or even R-SbM. By removing the need of calculating capital requirements for vega and curvature risks, by simplifying the calculation of basis risk and by reducing correlation scenarios in intermediate calculations, Basel has given a bit of comfort to banks in adopting these new standards; especially to banks that don't have substantial exposures in non-linear financial instruments. However, in the kingdom and in the region, there are big banks that in spite of having a D-SIB status have insignificant proprietary exposures on their trading books originating from non-linear financial instruments. These banks will not be able to benefit from the R-SbM approach at all because of a pre-condition placed by Basel that excludes G-SIBs or D-SIBs from using it (Section1 Para 204). Such banks will have to continue to calculate their 'non-linear' risk without much addition to their overall market risk capital charge through SbM. Nevertheless, R-SbM is a good initiative and a practical approach to facilitate a smooth transition from the simple original standardized approach to a more calculation intensive and rigorous revised SbM. It would be more prudent and acceptable if Basel could remove the condition of excluding D-SIBs from utilizing it, at least for a first couple of years. This way even D-SIB's be able to benefit from R-SbM and have ample time to test and refine their methodology to eventually adopt SbM for their market risk capital charge calculation.

Bank 2

The CD provides the necessary eligibility conditions for banks to be able to apply R-SbM, which will need to be assessed quarterly. We recommend that the assessment should not be done at a point-in-time but rather be based on an evaluation of multi-period assessments (e.g. over a period of two consecutive quarters). We believe that this will avoid abrupt changes from one approach to another at each each quarter-end based on the eligibility assessment. Also, we believe that if a bank loses the eligibility to utilize R-SbM, then an appropriate period of time should be allowed for the bank to develop the required infrastructure to calculate market risk capital charges under the more complex SbM approach.

In paragraph 204, one of the criteria mentioned to evaluate eligibility for R-SbM is where total market risk RWAs are less than 5% of total RWAs. We would like to understand the rationale for such ratio as some banks could still have market RWAs higher than 5% even if they have linear risk products like FX, Interest Rate Derivatives and Equities. In addition, it needs to be clarified that the applicable market risk RWAs relate to Pillar 1 only. It appears that our bank is presently eligible for the proposed R-SbM approach, but still we also continue to believe that a sensitivity based framework even for capturing a delta risk capital charge, will involve significant implementation effort, which costs potentially disproportionate to the gains achievable using the new approach to manage trading books risks. We therefore believe that if the option to retain the current Basel II Standardized Approach with further suitable modifications is available, then we would strongly support this option rather than the R-SbM. We also believe that not only would this be appropriately risk sensitive to material market risks arising out of our banking book activity, it would also be more cost-effective for purposes of our risk based capital assessment. We are also concerned that a requirement to implement R-SbM will divert attention and resources from other major upcoming changes such as the revised approach for operational risk, credit risk, IRRBB and other elements of Basel III, as well as the considerable efforts required to adopt the new IFRS9 methodologies. Therefore, we strongly recommend retaining the current Basel II Standardized Approach (with further suitable modifications, if any) for banks such as ours.